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TOWARD UNDERSTANDING OUR ECONOMY
The Pricing of Farm Food Products

by
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Earlier letters in this series have considered the general economic aspects of such terms as demand, supply, and prices. This letter focuses more directly on the interaction of supply and demand as price-making forces.

Prices Allocate Production and Consumption

The function of prices is to allocate the production and consumption of goods and services, both as between commodities and services, and between whole groups of commodities. A small supply encourages higher prices and hence, increased future production. A large supply tends to keep prices low, and hence to reduce future production.

The "normal" price is the one at which the amount producers want to produce and the amount consumers want to consume are in balance. If this point is reached, prices will tend to remain quite steady. The price, however, may be either high or low in relation to individual costs of production. If it is low, the inefficient firms will quit producing at some point; if it is high, new firms will tend to enter into the production of the item or items.

Thus a low price discourages production because it is an indication that consumers place a low value on it--they are not willing to pay a higher price to obtain larger quantities. A producer may actually choose the lower price if he can sell enough more of the items to make his total profits larger. This is the basis of mass production. It results from the efficiencies to be gained by producing in larger quantities which distributes the fixed costs over a larger output. Farmers, for example often feel the need for more land over which to run their expensive equipment in order to cut the costs per bushel.

Prices To The Farmer and The Consumer

The individual farmer must accept the price that available markets offer him because he is not individually a large enough producer to influence the quantity sold and thus the price. On the other end of the chain, the consumer finds that he must pay the price asked of him, or go without, since he individually has no noticeable influence on the quantity bought and thus the price.

Consumers want to eat, but they eat only about the same number of pounds of total food per person year in and year out. Thus if they find the price of a commodity quoted too high, they refuse to buy it and buy something else instead. If a can of peas on the grocery shelf is marked at 28¢, the consumers may refuse to buy. If the peas do not sell fast enough, the grocer will have to lower the price to get rid of them, but he probably will not reorder as many.

This reaction to the price is transmitted back down the line to the farmer. Since the present supply is already determined, the farmer must take what he is offered or hold it. Holding often does not solve the problem because it adds to the total supply available in the next period. But the price he receives for his produce serves as a basis for him to adjust his production in the next period. Often, many farmers make the same decision to shift production to some other commodity that appears to offer higher returns. The resulting low supply in the next period forces prices much higher.

Each producer and each consumer, acting in his own best interest, thus contributes to the total supply and demand fluctuations which produce the rapidly changing prices. It is not usual, however, that all of the buyers and all of the sellers can get together and determine one price that will transfer all of the commodity from the producers to the consumers. The commodity is transmitted from one to the other on the basis of many informed and uninformed guesses and assessments of the supply and demand factors. Thus the price may change from day to day as new information is obtained by buyers and sellers all along the line.

Consumers Have The Veto Power

Advertising, information about nutrition, changes in incomes, and other factors can change the demands of consumers. But their willingness to pay certain prices indicates their relative demand for different commodities. Consumers today will not pay much for bread flour; they'd rather pay for some additional services if necessary to buy their bread already baked.

The store manager and each of the processors have fixed costs in the form of labor, rent, utilities and so on that he must recover in his sales. If he cannot pass the cost on the consumer, he must try to buy cheaper. Again, the end of the chain is the farmer who has the product in his hands. Often, but not always, he must reduce the price that he would like to get if he wants to sell it. Some of the reduction may be accepted by the processor in order to maintain an efficient volume, however.

January "sales" are often evidence that store managers made some wrong guesses in June and July about the number of items they thought they could sell for Christmas. Once they made the decision to buy the goods and have them on hand, they must sell them someway. The effective demand (ability and willingness to buy) has more effect on the current price than any other factor.

Since consumption, particularly of farm food products, changes less rapidly than supply, the major changes in price from year to year are caused by changes in supply. The unwillingness of the consumer to increase his total food consumption, coupled with increased production, keeps the over-all price level low in agriculture. The low price thus implies over-production. Likewise, low prices (relative to others) for certain commodities, indicates that there is overproduction in those particular items. The pricing system is calling for adjustments.

The successful manager usually is the one who takes advantage of all of the information available to him in making his decisions. He watches closely for new ways of doing things, particularly those that will reduce his unit costs. He tries to keep up with, and foresee, changes in consumer demand for his and other products. In short, he tries to make the market system work for him rather than against him.

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